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AGENDA ITEM 6

TO: MEMBERS OF THE INVESTMENT POLICY SUBCOMMITTEE

- I. SUBJECT:** Policy Review and Consolidation Project – Revision of Global Equity Policies
- II. PROGRAM:** Global Equity
- III. RECOMMENDATION:** Recommend to the Investment Committee:
 - a. Approval of the revised Statement of Investment Policy on Corporate Governance Investments
 - b. Adoption of the Statement of Investment Policy on Externally Managed Strategies (consolidation of Global Equity externally managed programs) and Related Repeals
 - c. Approval of the revised Statement of Investment Policy on Monitoring Externally Managed Portfolios
 - d. Repeal of the Statement of Investment Policy on Passive International Equities – Externally Managed
 - e. Adoption of the Statement of Investment Policy on Internally Managed Affiliate Equity Index Funds (consolidation of policies for Standard & Poor's 500 Equity Index Fund Internally Managed programs) and Related Repeals
 - f. Revision of the Statement of Investment Policy on Internally Managed Global Equity Index Funds and Repeal of the Statement of Investment Policy on Dynamic Completion Fund

- g. Revision of the Statement of Investment Policy on Internally Managed Global Enhanced Equity Strategies
- h. Revision of the Statement of Investment Policy on Risk Managed Absolute Return Strategies Program

IV. ANALYSIS:

Background

The objectives of the Policy Review Project are (1) to organize and streamline Investment Policy to improve access, clarity and transparency, (2) to provide a consistent Investment Policy framework, and (3) to ensure that the policies will facilitate the on-going CalPERS compliance program.

On June 18, 2007, Investment Office staff provided the Investment Committee with a briefing on the project. At this time, staff presented the revised policy template, which is designed to provide consistency across policies. In addition staff presented the new Table of Contents (Attachment 1), which is designed to reflect a top-down and cross-asset class organizational approach. Finally, to facilitate the top-down approach, the Committee approved a new overarching Statement of Investment Policy for the Total Fund.

The Policy Review Project entails a detailed review of each policy with the goal of updating and streamlining the policy, as well as potential consolidation with other related policies. In addition to these goals, the review and revisions include the following:

- Removal of delegations from policy. During the Delegations Project, staff reviewed all policies, minutes, and delegations to identify and consolidate delegations. Delegations are now located in consolidated documents.
- Removal of operational and procedural language, which is now located in staff internal procedure manuals.
- Conformance to the new template.

Clean and black-lined versions are provided for each policy. As a general rule, the revised policies have not been changed substantively. Substantive changes that were deemed necessary at this time have been highlighted for the Subcommittee's convenience.

The review is a joint effort and includes input from the General Pension Consultant, the CalPERS Legal Office, and the Enterprise Office of Compliance.

The policies are being brought forward to the Policy Subcommittee on a phased basis. The policies being presented in this item are Global Equity policies. A summary of the Global Equity policies and recommended Subcommittee action is included as Attachment 2. As a result of consolidation, there are now 11 policies instead of 17. Substantive revisions to each policy are explained below.

Wilshire's opinion letter, supporting the policy revisions for all policies presented in this item is attached (Attachment 3).

a. Revision of Corporate Governance Investments (Tab 5a)

Attachment A (Externally Managed Program), Section II.A.1 describes allocation parameters for Corporate Governance Funds. This policy provision has been removed because allocations to Corporate Governance funds are established by the Investment Committee and set forth in the Global Equity Sub-Asset Class Allocation Ranges policy.

External Equity Policies

b. Adoption of Externally Managed Strategies and Related Repeals (Tab 5b)

The adoption of the Externally Managed Strategies policy will consolidate the following externally managed policies: (1) Active Domestic Equities, (2) Active International Equities, (3) Domestic Enhanced Index Strategy, (4) International Enhanced Index Strategy and (5) Relaxed Long-only Domestic Equity Strategy. Specifics on these five programs will be included as attachments to the overarching Externally Managed Strategies policy.

No substantive changes were made. However, the policy and attachments were edited for clarity and to conform to the new template.

c. Revision of Monitoring Externally Managed Portfolios (Tab 5c)

No substantive changes were made. However, the policy was edited for clarity and to conform to the new template. Additionally, the policy name was changed to Monitoring Externally Managed Portfolios.

d. Repeal of Passive International Equities – Externally Managed (Tab 5d)

CalPERS' entire passive international equity portfolio is now managed internally. Therefore, this policy is obsolete.

Internal Equity Policies

e. Adoption of Internally Managed Affiliate Equity Index Funds and Related Repeals (Tab 5e)

The Internally Managed Affiliate Equity Index Funds policy is modeled after the Internally Managed Global Equity Index Funds policy. This new policy replaces the Pooled Standard and Poor's 500 Equity Index Fund – Internally Managed and the Deferred Compensation Standard and Poor's 500 Equity Index Fund – Internally Managed Policies. Other changes include:

1. Revision of Return Deviation Ranges – To create consistency in the performance expectations, the limitation on fund performance variation for the Pooled Standard & Poor's 500 Index fund was changed from 13 basis points to 20 basis points annually. The 20 basis point performance variation range is consistent with that applied to the Deferred Compensation Standard & Poor's 500 index fund.
2. Revision of Reporting Requirements – The original policies discussed, in detail, numerous reports generated for each strategy. This detail has been removed and included in the Staff procedure manuals.

f. Revision of Internally Managed Global Equity Index Funds and Repeal of Dynamic Completion Fund (Tab 5f)

The changes in the Internally Managed Global Equity Index Funds policy document are the inclusion of the Dynamic Completion Fund language into the document, and:

1. Removal of the "Watchlist" Language – Watchlist issues are addressed in the quarterly performance reporting done by the General Pension Consultant. Any issues related to performance of these funds shall be identified for the Investment Committee in a timely fashion.
2. Removal of "Tracking" Language – The original policies discussed the differences between the calculation methods used in equity benchmark construction and the actual practices used to manage the index investment portfolios. This discussion, while germane to the results achieved in the programs, does not constitute any

particular “policy” that relates to the management of the funds. For this reason the section was removed.

3. Elimination of Section Dealing with Concentrated Risk - The original policies discussed concentration risk. Concentration risk is measured at the entity level, as opposed to the portfolio level; therefore, this policy provision does not apply to individual portfolio policies and has been removed.
4. Revision of Reporting Requirements – The original policies discussed, in detail, numerous reports generated for each strategy. This detail has been removed and included in the Staff procedure manuals.

g. Revision of Internally Managed Global Enhanced Equity Strategies (Tab 5g)

One change was made to the Internally Managed Global Enhanced Equity Strategies policy document. The original policy discussed, in detail, numerous reports generated for each strategy. This detail has been removed and included in the Staff procedure manuals.

Risk Managed Absolute Return Strategies Policy

h. Revision of Risk Managed Absolute Return Strategies (Tab 5h)

The recommended changes to the Statement of Investment Policy for Risk Managed Absolute Return Strategies (the “Policy”) do not represent a substantive change from the previous RMARS policy.

The Policy Review Project has in large measure attempted to coordinate and harmonize policies across asset classes, and many of the changes to the Policy reflect these efforts. For example (and as noted above), the concept of delegation has been removed from section III of the Policy, as delegations are addressed in consolidated documents rather than in individual policies. The role of the General Pension Consultant is also spelled out in the Policy for the first time, consistent with the goals of the Policy Review Project.

Other changes are as follows:

- Refinement of Staff’s responsibilities and refinement of the “Absolute Return Strategic Advisor” definition and concept. (See Section III(B), which sets out Staff’s responsibilities, Section III(C), which sets out Strategic Advisors’ responsibilities, and the definition

of “Absolute Return Strategic Advisor” in the Policy’s glossary.) These refinements clarify each group’s roles and allow for flexibility in the particular responsibilities undertaken by each Strategic Advisor.

- Replacement of the term “General Partner” with “Investment Manager” throughout the Policy. This change is to eliminate possible confusion about the type of corporate structure required of firms or professionals managing RMARS portfolio funds. Absolute return funds can be in various non-partnership formats such as LLCs which do not call for the existence of a general partner.
- Removal of concepts which are more applicable to private-equity funds than absolute-return-funds. For example, Section V(A)(4), which discusses terms to be negotiated, previously included concepts such as “carried interest,” “clawback,” and “return of capital” which are not terms of common usage in the absolute-return universe.

The following policies have been recently approved by the Policy Subcommittee. All of these policies conform to the new template format. These policies are not presented for Subcommittee action.

Policy Name	Approval Date
Global Equity Sub Asset Class Allocation Ranges	September 10, 2007
Emerging Equity Markets Principles	November 13, 2007
Manager Development Program I and II (MDP) Policy and Manager Transition Policy	November 13, 2007

V. STRATEGIC PLAN:

This item is consistent with the Strategic Plan: Goal VIII, manage the risk and volatility of assets and liabilities to ensure sufficient funds are available, first to pay benefits and second to minimize and stabilize contributions.

VI. RESULTS/COSTS:

These are no material costs associated with this agenda item

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